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5 February 2021

The Financial Reporting Council
8th Floor
125 London Wall
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Email: futurereporting@frc.org.uk

Dear Sir/Madam,

Re: The international business of Federated Hermes' response to the FRC consultation on the future of corporate reporting.

Federated Hermes is a global leader in active, responsible investment. We are guided by the conviction that responsible investing is the best way to create long-term wealth. We provide specialised capabilities across equity, fixed income and private markets, in addition to multi-asset strategies and proven liquidity-management solutions. Through our world-leading stewardship services, we engage companies on strategic and sustainability concerns to promote investors' long-term performance and fiduciary interests. Our goals are to help individuals invest and retire better, to help clients achieve better risk adjusted returns, and where possible, to contribute to positive outcomes in society. As of 31 December 2020, Federated Hermes had $619.4bn assets under management[1] and $1.3tn assets under advice.

Hermes Investment Management and Federated Investors rebranded as Federated Hermes in February 2020. All activities previously carried out by Hermes Investment Management now form the international business of Federated Hermes.

EOS at Federated Hermes ("EOS") is a leading stewardship provider. Our engagement activities enable long-term institutional investors to be more active owners of their assets, through dialogue with companies on environmental, social and governance (ESG) issues. We believe this is essential to build a global financial system that delivers improved long-term returns for investors, as well as better, more sustainable outcomes for society. EOS represents $1.3tn of assets under advice as of 31 December 2020. EOS conducts proactive and reactive engagement with the companies in which its clients invest on a regular basis on environmental, social, governance, strategy, risk and communications concerns. Our team engages in active stewardship on behalf of clients, providing vote recommendations for annual meetings and participating in other shareholder gatherings to achieve our clients' responsible ownership aims and fulfil their fiduciary duty to be active owners. EOS is a stewardship services provider and does not carry out registered activity.

We welcomed the opportunity to participate in the Financial Reporting Council's (FRC) future of corporate reporting advisory group and recent roundtables on the topic. We also appreciate the opportunity to provide our comments on the advisory group's thought leadership paper "A matter of principles – the future of corporate reporting" ("the paper").

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[1] Please note the total AUM figure includes US$54.1bn managed by the international business of Federated Hermes, of which US$8.5bn of assets are managed or under an advisory agreement by Hermes GPE LLP ("HGPE"). US$69.7m of total group AUM figure represents HFM mandates under advice.

Source: Federated Hermes as at 31 December 2020.

We have shared our response with our clients and provide our permission for this response to be made public. The views expressed in this communication are those of EOS at Federated Hermes / The international business of Federated Hermes and do not necessarily represent the views of all clients. Our response to this consultation is explicitly supported by PNO Media (the Netherlands).

Our responses to the FRC's specific questions are as follows:

General
What are your views on our proposals as a whole? Are there elements that you prefer over others?

We welcome the FRC's proposals on the future of corporate reporting and see the paper as providing considered and thoughtful solutions towards achieving more coherent and relevant content and addressing challenges such as the dispersed and fragmented nature of many reports. We recognise there is a need to meet the interests of a broader group of stakeholders in addition to shareholders and welcome the paper's concepts of stakeholder neutrality and objective driven approaches to reporting. We also recognise the increasing role technology offers to enhance reporting and connectivity between conventional financial reporting and disclosures that focus on natural and social capital matters. We are pleased the FRC has considered technology as an enabler for the reporting network.

We welcome the FRC's focus on an objective-driven approach to reporting and the development of a common set of principles – including both system level as well as report level attributes - to establish coherence across all company reporting. We view the principles-based framework for corporate reporting, as outlined in the FRC paper, has having merit. We note the approach is consistent with other corporate reporting developments outside the UK and the renewed emphasis on the public interest role of companies, aligned with purpose and its key stakeholders. We also view the approach as assisting companies with meeting requirements under section 172 of the UK Companies Act[2]

In responding to a new proposed "system" of reporting we are mindful that companies have a wide range of standards and frameworks to choose from. In most cases companies are reporting under multiple frameworks including rating agencies. Many public interest entities (PIE)[3] are mature in their reporting approach and have entrenched procedures, policies and controls which would require change, operationally and culturally, to shift to a digital network reporting approach. This has the potential to impact acceptance and adoption of the FRC's approach.

The current market for enhanced corporate reporting is evolving. The FRC is not alone in seeking an enhanced systems-based approach. The International Integrating Reporting Council (IIRC) advocates the application of principles such as connectivity of information as part of an evolving reporting system[4]. We note broader developments from the independent reviews of the FRC by Sir John Kingman, the review into the quality and effectiveness of audit by Sir Donald Brydon as well as the International Financial Reporting Standards Foundation (IFRS) proposal for the creation of a sustainability standards board. In addition, regulators, non-government organisations and other

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[2] UK Companies Act 2006, section 172 (1) to (3) "Duty to promote the success of the company", sourced from https://www.legislation.gov.uk/ukpga/2006/46/section/172

[3] Defined in the paper by the FRC as including UK companies with equities or debt admitted to trading on a regulated market (including the London Main Market but not the Alternative Investment Market) and credit institutions and insurance understandings (page 31).

[4] IIRC (January 2021) International Integrated Reporting Framework

actors are working independently to develop standards for reporting on social and natural capital matters, for example on climate. This activity is adding to the complexity and confusion for companies and investors. We would urge the FRC to collaborate more with key standard setting organisations, including the recently merged IIRC and Sustainability Accounting Standards Board (SASB), with the view to harmonising its reporting network approach.

In summary, we found the paper provides a considered approach for next generation corporate reporting, and articulates well accepted concepts such as materiality, objective-driven communications, technology as an enabler and a principles-based approach. Where we would like to see further consideration by the FRC is in a strengthened case for change including costs and benefits, implementation challenges/opportunities, more collaboration with standard setters and insight on the current state of XBRL taxonomies and expected demand. We also think the paper could be strengthened by emphasising the importance of companies stating their business purpose and using it to inform key aspects of their corporate reporting.

Implementation
***What do you see as the key practical challenges of implementing our proposals*?**

We see three areas which may present practical challenges to implementation. First, gaining widespread acceptance and adoption by boards and companies of the new network reporting model. Critical to wide ranging acceptance will be a strong case for change to challenge the status quo and how the proposal harmonises with global sustainability standards.

The second practical challenge is how the reporting network proposed will be implemented. Of immediate focus is guidance on the content in the public interest and business reports that concerns topics focused on natural and social capital. Principles alone may not be sufficient to guide decisions on useful content by reporters. The paper mentions the sustainable development goals (SDGs) but stops short of discussing the suitability of existing standards and frameworks. Companies will seek that guidance, and without a standardised approach to what the FRC terms “non-financial disclosures” there is a risk to comparability. For example, a closer signposting to the SDGs would be helpful, including expansion of the paper’s suggested approach on page 26 to identify the SDGs to which the external outcomes relate and identify how a company’s activities are contributing to societal impacts. Going forward, robust collaboration with standard setters will be key.

The third challenge relates to the competency, knowledge and skills of the board, audit committee and independent auditor. The paper contemplates the board having overall collective responsibility for the reports in the reporting network, including approving natural and social capital content in the mandatory reports and the public interest report. Ideally the board would have the requisite knowledge of material natural and social capital issues that affect the business. It is our view that many company directors do not currently have the skills and knowledge to ask the right questions, support or challenge management as needed and ultimately make informed decisions affecting strategy and risk for these matters. Climate change is a clear example of a material topic for many sectors where corporate boards, for the most part, do not have the expertise to address the business challenges driven by a changing climate and decarbonized future[5].

[5] Ceres (2017) “Lead from the top: building sustainability competence on corporate boards”.

Federated Hermes

Do you have any suggestions on how the above could be overcome?

While the paper discusses some of the drivers for a new approach, the case for change could be further strengthened, specifically, how the paper's proposed reporting network overcomes challenges such as easing the reporting burden on companies, alignment with reporting standards and frameworks, meeting regulatory requirements and reducing costs associated with disclosures.

We recognise the development of global standards for ESG reporting is a longer-term proposition. While accounting standards were outside the scope of this position paper, guidance on existing standards that the FRC believes would meet the objectives of the reporting network would be helpful to companies. For example, the IIRC's recent revisions to the integrated reporting framework published in January 2021 aim to enable more decision-useful reporting. These revisions draw on different reporting stands, communicating a full range of factors that materially affect a company's ability to create value over time. We specifically note the intended focus of the IIRC framework on conciseness, strategy, future orientation and information connectivity, all of which are complementary to FRC's proposed approach.

We believe corporate boards will face challenges and risks performing their fiduciary duties without basic skills and competency levels in environmental and social matters. We expect independent chairs, lead independent directors, other non-executive directors and board committee chairs to engage on these topics with investors and other stakeholders where they have particular concerns or interests. In addition, challenges may be overcome through active and strategic board refreshment, the role of the independent chair in improving the effectiveness of board debates and accountability to stakeholders, increased board diversity and evidence of regular analysis of how the board as a whole displays the necessary skills, independence and attributes to meet the company's evolving needs. The need for competency in non-financial matters should also apply to the company's independent auditor and board audit committee.

***What do you see as the costs and benefits of the new model*?**

For existing preparers there may be costs and complexity associated with aligning to the network reporting approach. For those new to ESG reporting, the approach would not necessarily reduce the costs or barriers to reporting through removing the need to research which is the most appropriate regime or regimes to report against. We also anticipate costs such as human capital and direct financial associated with the enhanced reporting approach enabled by a structured data framework such as that contemplated by the paper. If the FRC has considered the costs to companies associated with its proposal we would urge it to disclose this information.

We have articulated several benefits we see with the FRC's approach under general discussion in this response. To the extent that the proposed approach drives more coherent and relevant content, addresses the dispersed and fragmented nature of disclosures, and improves connectivity between information and data through enabling technologies, we see significant benefits to corporate reporting and to stakeholders.

Objective driven
***Do you agree that corporate reporting should focus on a wider group of stakeholders*?**

Yes. We support the notion that corporate reporting should focus on a wider group of stakeholders. It is our belief that companies can only create and preserve long-term value if they profitably provide goods and services that meet societal needs in a positive manner. To achieve this, we expect companies to be guided by a business purpose that serves not only shareholders, but other stakeholders, society, and the environment. Business purpose should identify the stakeholders most critical to long-term value creation, and specify the timeframes used to evaluate long-term strategy and capital allocation policy.

We also recognise the need for companies to balance the needs and interests of their various stakeholders. We encourage companies to use corporate reporting to demonstrate how they find that balance.

Do you agree that reports should be driven by their objective instead of a primary user-focused approach?

We agree that reports should be driven by objectives (i.e., issues that concern harm to natural and social capital, and which, unmitigated, are likely to cause financial harm not just to stakeholders but to shareholders over the long-term disclosure). We would urge caution against drawing too fine of a line between the types of disclosure, given the historic tendency of materially relevant ESG factors to be externalised and not reflected in conventional financial statements. Therefore, we urge the objectives to consider integrated reporting concepts such as natural and social capital, that recognise value creation for various stakeholders as inherently interconnected rather than as separate goals to be pursued in tandem.

One set of principles
Do you consider the principles of good reporting would be helpful in improving the quality of corporate reporting?

Guidance to improve the quality of corporate reporting disclosure is always welcome. We recognise that companies have access to a wide range of standards and frameworks, including principles-based auditing standards, which provide guidance for quality reporting. We see some alignment between the FRC's proposed principles with existing principles. We would caution against proliferating principles and rules where possible.

Reporting network
Do you agree with our approach to improving the relevance and accessibility of information, involving more concise reports distributed across a reporting network?

Yes, we agree and support approaches that aim to improve the relevance and accessibility of information, including communication principles as disclosed on page 12 of the paper to guide the preparation of individual reports. We would add that additional goals should be to reduce complexity and the volume of corporate reporting, thereby minimising the burden of information overall.

Materiality

We are proposing that there should no longer be a single test for materiality that is based on accounting standards. Do you agree with this approach?

We agree. The traditional concept of materiality needs to evolve. The application of materiality as a filter for determining decision-useful information needs to encompass environmental and social considerations more consistently, including the basis on which materiality judgements have been made. This is key to setting effective and meaningful strategy at the company level. We see the materiality approach outlined by the FRC as a forward step in the dialogue regarding materiality being viewed in a wider context. It is also consistent with the notion of dynamic materiality, that is, issues or information material to environmental and social objectives may develop to have financial consequences over time[6].

Non-financial reporting

***Do you agree that there is a need for regulatory standards for non-financial reporting*?**

We support the development and adoption of internationally recognised standardised reporting frameworks applicable to the most material long-term value areas providing the same rigor and relevance as financial accounting standards and subject to the same degree of auditability. In this regard we prefer standard setters to self-organise a streamlined approach to consistent and coherent global reporting and welcome recent developments such as the merging of the IIRC with SASB. We note the work of the Impact Management Project to provide a mechanism for delivery of a complete set of standards benefiting companies, investors and public entities in order to ensure long-term value creation.

Once a streamlined standard has emerged from standard-setters and there has been some take-up in corporate reporting, there may in future be a role for regulators in mandating minimum standards of disclosure in line with this standard. We have seen the same thing with the TCFD framework – after a significant voluntary implementation we are now seeing it introduced on a mandatory basis in some jurisdictions, including the UK.

The development of taxonomies and accompanying corporate disclosure is a useful avenue for regulatory reporting to explore, to help investors understand the outcomes an investment is contributing to. A UK taxonomy has already been announced.

***What do you consider the scope of information that should be covered by those standards*?**

The long-term outcomes we seek include purpose-led, timely, reliable, comparable, and comprehensive reporting which enables investors and other stakeholders to accurately appraise past performance and future prospects of a company. We seek comprehensive reporting of all material elements of a company's impact on wider society and company explanations through an integrated reporting approach on how value is created over time. It is our belief that investors are increasingly looking for a form of integrated reporting that provides a holistic approach to a company's value-creation story and enables more relevant accessible insight. This is particularly relevant as market

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[6] SASB (September 2, 2020) Double or dynamic: understanding the changing perspectives of materiality, source from https://www.sasb.org/blog/double-and-dynamic-understanding-the-changing-perspectives-on-materiality/

value shifts further towards intangible assets and increases the materiality of topics such as climate, intellectual capital, research and development, brand value and natural and human capital.

***Do you agree with the need for companies to provide information about how they view their obligations in respect of the public interest*?**

Yes, we agree with the need for this form of disclosure, viewing it as very much aligned with a company's statement on purpose and its obligations in respect of the public interest. By aligning disclosures with a corporation's statement of purpose, investors and stakeholders can more easily connect purpose to long-term capital allocation, strategy, and the impact of the company's activities. We recommend the FRC consider incorporating purpose into the objective of the public interest report, specifically how the company views its purpose (and obligations) in respect of the public interest.

***Do you consider that reporting by a company in respect to the public interest should be dealt with through a public interest report*?**

We are somewhat open on the form a company selects to disclose decision-useful information whether it be in a specific report or through other means. That said, we welcome the FRC's proposal of bringing together all related, material non-information into one place.

***Do you agree with the suggested content of the public interest report*?**

We support the FRC's consideration of a set of minimum requirements for public interest disclosures as this helps comparability. It would be helpful to companies and investors for the FRC to provide an assessment of existing standards and frameworks that best achieve the communication objectives of the special interest report.

Technology

***Do you see any other ways that current and new technology could be used to facilitate the proposed model and support the overall attributes of corporate reporting*?**

We welcome the focus by the FRC on digitisation and a shift away from the notion of physical reports. We recognise there is growing appetite for information in a machine-readable form with improved tagging to promote cohesion and interconnectivity (and transparency) of disclosures. This is consistent with research conducted by the US National Bureau of Economic Research which found that companies are shaping their disclosures for a predominantly artificial intelligence (AI) audience of algorithmic traders, robot investment advisors and quantitative analysts[7]. We note work by the UK Impact Management Project in this area exploring the creation of a global registry of taxonomies to design and align machine-readable formats of existing sustainability standards and frameworks. A common thread emerging from the discourse is the present lack of a common digital taxonomy for ESG data and the development of tagging requirements. We also note a latent demand for XBRL. These elements underpin the success of FRC's digital vision for corporate reporting and would benefit from more discussion on anticipated timelines for taxonomy development and expected demand, including the evolution to AI and cognitive-based reporting.

[7] National Bureau of Economic Research (October 2020) How to talk when a machine is listening: corporate disclosure in the age of AI

Proportionality

***Do you agree that the model we propose will achieve a proportionate reporting regime for companies of different sizes and complexity*?**

We view the proposed model as immediately aimed at PIE as prudent. As discussed earlier in this response a key challenge with the FRC's reporting network will be adoption by companies. We see benefits in acceptance and adoption of the FRC's proposal by a proportionate reporting regime particularly as it reduces the burden on smaller and private companies. That said, in general, we find disclosures by private and smaller companies to be limited. This in turn creates challenges for investors and other stakeholders in determining risks and accessing decision useful information. We suggest leaving the option open for smaller companies to develop a business and public interest report if they choose to.

Please contact me if you would like to follow-up with a more thorough discussion: joanne.beatty@hermes-investment.com.

Yours faithfully,

Joanne Beatty
Director-Engagement at EOS